Export Subsidy Commitments: Few Are Binding Yet, But Some Members Try To Evade Them

In the Uruguay Round of the GATT, 25 countries that employed export subsidies agreed to reduce the volume and value of their subsidized exports over the period 1995/96 to 2000/01. To date, most of these countries have met their commitments, although some have devised schemes to circumvent them. The EU, by far the largest export subsidizer, holds an 84-percent share of 1995 and 1996 subsidy outlays for the 25 countries since it relies on export subsidies to bridge the gap between high domestic support prices and lower world prices. Despite substantial progress in reducing export subsidies, rising world grain supplies and falling world grain prices could require some countries to adopt policy changes in order to meet their future commitments.
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Introduction

The URAA imposed meaningful disciplines on agricultural export subsidies for the first time (see box "The Uruguay Round Agreement on Agriculture and Export Subsidies"). Prior to URAA implementation, export subsidies significantly distorted agricultural trade. During the late 1980s, the United States and EU engaged in a "subsidy war" in which both countries battled to undercut each other's prices in wheat export markets. Over the decade, U.S. market share declined while EU market share increased dramatically. Other exporters such as Argentina, Australia, and Canada advocated the elimination of export subsidies which they argued increased pressure on their national treasuries and pushed them out of some export markets.

Experience with Export Subsidy Commitments

Each year, WTO members are required to notify the WTO Committee on Agriculture concerning the volume of their subsidized exports, their expenditures on export subsidies, and the volume of their unsubsidized exports, by commodity, as specified in their country schedules. As of July 1, 1998, most countries' notifications had been received for 1995 (1995/96 for some countries) and 1996 (1996/97), the first 2 years of URAA implementation. Of the 25 members with export subsidy commitments, all but one have submitted notifications for 1995 (Colombia) and 1996 (Mexico).

Based on the available WTO notifications, high world grain prices kept countries' use of export subsidies well below their WTO commitments in both 1995 and 1996. The EU, typically the largest user, even imposed taxes on grain exports. These events were unforeseen at the time the URAA was being negotiated. Now that world grain prices have fallen, however, meeting commitments for these goods may become more difficult.

Of the 25 countries that have export subsidy commitments in their WTO schedules, the EU by far employs the most export subsidies (figure 6). The EU accounted for nearly 84 percent of the $7.6 billion of export subsidies notified to the WTO for 1995 and $8.4 billion reported for 1996 (as of July 1, 1998). Based on which volume commitments were nearly filled in both 1995 and 1996, it appears that the EU is most reliant on subsidies for cheese, other milk products, bovine meats, olive oil, poultry, and fresh fruit and vegetables. In years of low world prices, the EU would also be reliant on subsidies for grain exports as well.

In contrast, the United States ranked ninth overall in export subsidy expenditures in 1995. The United States allocated roughly 80 percent of its less than $26 million in export subsidy expenditures to dairy products (mostly skim milk powder) and the remainder to poultry meat. U.S. expenditures increased to $121 million in 1996. All U.S. subsidies were for dairy products, of which nearly 80 percent went toward exports of skim milk powder.

Only four countries exceeded one or more of their value commitments in 1995, and two did in 1996 (see table 5). The largest expenditure overrun in percentage terms was by Cyprus for Halloumi cheese in 1995 (405 percent of its value commitment of $195,000 and 189 percent of its volume commitment of 986 tons). In 1996 Cyprus fully filled both its volume and value commitments for Halloumi cheese. For Cyprus to meet its cumulative commitments by the 2000/01 deadline, it will need to severely limit export subsidies for Halloumi cheese in the years prior to 2000/01.

South Africa, the second largest user of export subsidies in 1995 and 1996, exceeded its expenditures on subsidies for cocoa and its volume commitments for wine in those years. However, the South African government terminated its export subsidy program in July 1997.

Figure 6
Countries' Shares of Total Export Subsidies (Value)

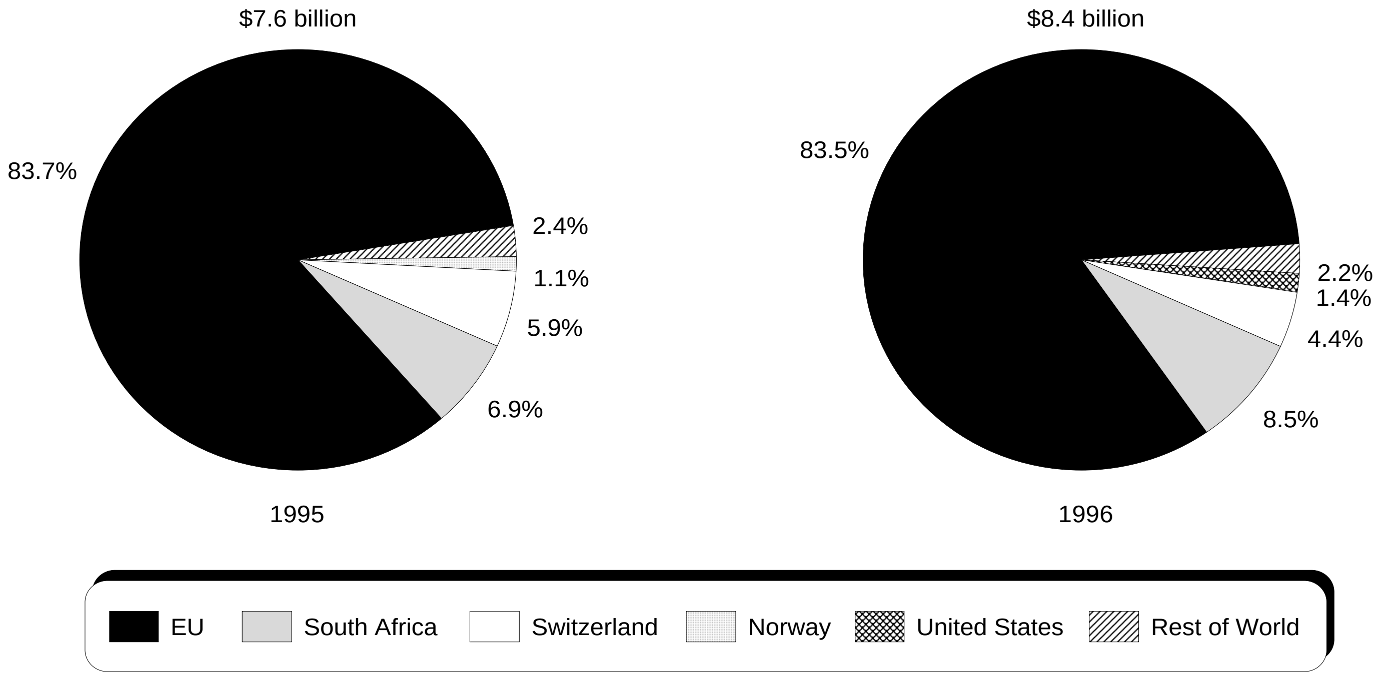

Table 5--Countries exceeding URAA commitments on export subsidies, 1995 and 1996

Country	Commodity	Commitment	Notification	Percent of commitment
		1995		
		1,000 dollars		
Cyprus	Cheese	195	789	406
Hungary	Coarse grains	1,727	4,862	282
Norway	Poultry	110	268	243
South Africa	Tea	1,667	1,865	112
	Cocoa	11,248	12,140	108
		Tons		
Cyprus	Cheese	986	1,860	189
Norway	Poultry	27	59	214
South Africa	Other milk product	444	616	139
	Beer	27,417	28,940	106
	Wine	23,598	24,217	103
Switzerland	Live animals	13,806	15,312	111
		1996		
		1,000 dollars		
South Africa	Cocoa	12,481	35,331	283
EU	Rice	64,795	91,550	141
	Wine	68,345	75,573	111
		Tons		
EU	Rice	157,100	226,500	144
	Olive oil	135,400	140,400	104
	Beef	1,010,900	1,177,400	116
	Wine*	2,742	3,035	111
Poland	Sugar	122,900	143,000	116
South Africa	Fruit & vegetable	235,791	240,599	102
	Wine	22,742	124,318	547

* thousand hectolitres

The Uruguay Round Agreement on Agriculture and Export Subsidies

The Uruguay Round Agreement on Agriculture (URAA) imposes disciplines on agricultural export subsidies for the first time and begins to reduce the use of export subsidies in agricultural trade. GATT contracting parties agreed to:

- reduce the volume of subsidized exports by 21 percent over 6 years from a 1986-90 base period level (14 percent over a 10-year period for developing countries), and
- reduce the value of export subsidies by 36 percent over 6 years from a 1986-90 base period level (24 percent over 10 years for developing countries).

Twenty-five members of the WTO are committed to reduce their export subsidies. Countries' WTO export subsidy schedules specify how much of each commodity can be exported with subsidy, and permitted subsidy expenditures for each commodity. Under the agreement, countries may not initiate subsidies for commodities that are not in their export subsidy schedules.

The text of the URAA provides some flexibility between years in terms of subsidy reductions. If a country exceeds its commitments in any of the years two through five, it must reduce subsidy levels the next year and assure that the total cumulative value of export subsidies and volume of subsidized exports over the entire implementation period is no greater than the totals that would have resulted from full compliance with its subsidy schedules. Member countries must meet their commitments in the last year of the implementation period (2000/01).

The URAA defined several types of export subsidies that are subject to reductions, including:

- direct export payments by governments to firms, industries, or producers of agricultural products contingent on export performance
- sales or gifts of government stocks at prices lower than acquisition prices
- export payments financed through government action, including payments financed by levies on producers
- subsidies to reduce export marketing costs, including handling and export-specific transportation, and
- subsidies on goods incorporated into export products.

GATT contracting parties agreed to exempt bona fide food aid transactions and widely available export market promotion and advisory services from the list of export subsidies. Countries also must restrict their use of other export marketing practices that could cause them to circumvent their export subsidy commitments.

Lastly, countries also agreed to discuss disciplines for the use of export credit and credit guarantee practices in the OECD.

In all other cases where countries exceeded their commitments in 1995, their export subsidies were well below their commitments for 1996. Thus, for the time being, they have met, or are at least close to meeting their requirements for the export subsidy implementation period under the URAA.

In 1996, the EU, Poland, and South Africa exceeded their volume commitments. The EU and Poland both claim that they can carry over unused portions of their 1995 commitments to make up for their overrun in 1996. Because the countries were far below their commitments in 1995/96, they argued that they have the ability to apply the additional amount not used in 1995/96 to any of the years up to 1999/00. Others argue that flexibility provisions in the agreement are meant only to deal with situations where a country exceeds its limits and has to pay back—not as an opportunity for countries to "bank" unused subsidies.

In 1995 and 1996, grains accounted for the largest volume of subsidized exports (see table 6), though they were far below commitment levels because world grain prices were high (especially in 1995). Fruits and vegetables, other milk products, beef, and sugar (in 1996) accounted for most of the remaining subsidized exports. These products, along with oilseeds and vegetable oils, have been allotted the largest permitted quantities in the countries' WTO export subsidy schedules. In terms of volume commitments, those that have come closest to being filled are other milk products, cheese, and bovine meats. Due to high prices, oilseed allotments were barely used in 1995 and only slightly more in 1996.

Implementation Issues

Very few countries have changed their policies substantially to conform with their export subsidy commitments or to

Table 6--Volume commitments used

Commodities	1995* Subsidized exports	1995* Commitment	1995* Share used	1996** Subsidized exports	1996** Commitment	1996** Share used	Change from '95-'96
	1,000 tons		Percent	1,000 tons		Percent	Percentage points
Wheat & wheat flour	4,350	59,452	7	14,110	42,820	34	26
Coarse grains	7,666	28,156	27	11,845	19,213	62	34
Rice	99	784	13	227	726	31	19
Oilseeds	5	2,799	0	4	638	1	0
Vegetable oils	202	2,000	10	140	1,765	8	-2
Oilcakes	0	360	0	0	74	0	0
Sugar	897	6,085	15	1,373	4,443	31	16
Butter and butter oil	155	631	25	287	594	48	24
Skim milk powder	399	754	53	359	666	54	1
Cheese	447	555	81	425	515	82	2
Other milk products	1,267	1,538	82	1,248	1,437	87	4
Bovine meat	1,020	1,561	65	1,178	1,486	79	14
Pigmeat	380	679	56	296	655	45	-11
Poultry meat	463	794	58	414	755	55	-3
Sheepmeat	1	29	4	1	38	2	-3
Live animals	59	171	34	66	165	40	6
Eggs	97	130	75	70	125	56	-19
Wine	297	842	35	470	812	58	23
Fruit and vegetables	1,594	7,256	22	1,894	6,646	29	7
Tobacco	16	268	6	4	250	2	-4
Cotton	0	55	0	0	54	0	0
Total	19,414	114,900	17	34,712	83,876	41	24

* Excluding Colombia.

**Excluding Canada, Colombia, Mexico.

plan for reduced commitments in the future. The most notable reforms are to South Africa's and Canada's export subsidies. South Africa ended its subsidy program in 1997 and Canada terminated its rail subsidy for exported commodities in 1995. The EU has to reduce its internal prices to avoid exceeding its export subsidy commitments in future years, particularly when the Central and East European countries join the EU-15. Of concern to many WTO members are export subsidy waivers and circumventions that undermine the substantial export subsidy disciplines of the URAA. The EU and Canada instituted export marketing policies that allow them to circumvent their export subsidy commitments. Hungary obtained a waiver from its export subsidy commitments, which it argues were miscalculated.

EU's export subsidy commitments and enlargement drive CAP reform: Ten Central and Eastern European (CEE) countries have applied for membership in the EU. The application of the CAP mechanisms to the CEE countries would be very costly to the EU. It would also increase prices and stimulate agricultural production in the CEE countries, increasing their reliance on export subsidies. The EU is close to meeting its WTO commitments on the permitted volume and value of export subsidies. If the CEE's accession forces the EU to subsidize the exports of many commodities, the EU would certainly exceed its export subsidy constraints. Thus, the EU has proposed the Agenda 2000 reforms of its CAP, further reducing price support to farmers and reducing the associated need for export subsidies. However, the Agenda 2000 proposals have not been widely embraced by the EU member countries, who ultimately will have to vote whether to adopt the reforms.

Even if the Agenda 2000 proposals pass in their current form, they do not tackle the issue of reliance on export subsidies for all products. Comparing the bound rate in 2000/01 to subsidized expenditures in 1995 and 1996, one can see where the EU may have problems meeting its commitments in the future (see table 7). Expenditures for many commodities were far above the final bound levels. Even with the Agenda 2000 reforms, the EU may still have difficulty meeting its WTO expenditure commitments for wine, and fruits and vegetables.

The EU subsidizes dairy product components: Clearly, some of the export subsidy limits have been binding. For example, the EU has started to export some processed cheese claiming that it is an amalgamation of butter, skim milk powder, and natural cheese, and then counting export subsidies on the processed cheese against subsidies for the three component products. This leads the EU to subsidize more cheese than was agreed upon in the URAA.

The EU claims that this is possible through a modified version of the "Inward Processing Relief" (IPR) system. Traditionally under the IPR, third country products are imported tariff-free, processed in the EU, and then re-

Table 7--Comparison of EU export subsidies in base period to 1995, 1996, and 2000 bound rate

Commodity	Base	1995	1996	2000 bound rate	Change from base to '95	Change from base to '96	1996/bound rate
		-- Million ECU --				-- Percent --	
Total agricultural export subsidies	11,438	4,885	5,565	7,446	-57	-51	
Wheat and flour	2,015	119	318	1,290	-94	-84	0.25
Coarse grains	1,636	303	389	1,047	-81	-76	0.37
Rice	58	30	72	37	-47	26	1.96
Oilseeds	43	0	0	28	-100	-100	0.00
Olive oil	85	62	39	54	-27	-54	0.72
Sugar	780	379	525	499	-51	-33	1.05
Butter/butter oil	1,481	256	552	948	-83	-63	0.58
Skim milk powder	431	141	170	275	-67	-61	0.62
Cheese	534	438	271	342	-18	-49	0.79
Other milk products	1,090	728	732	698	-33	-33	1.05
Bovine meat	1,958	1,507	1,527	1,254	-23	-22	1.22
Pigmeat	299	101	71	191	-66	-76	0.37
Poultry meat	142	116	73	91	-18	-48	0.80
Eggs	68	13	7	44	-81	-90	0.16
Wine	61	51	60	39	-17	-3	1.52
Fruit and vegetables	96	82	72	61	-15	-25	1.18
Tobacco	63	18	3	40	-71	-95	0.08
Incorporated products	448	491	566	413	10	26	1.37
Other agricultural products	150	51	119	96	-66	-21	1.23

exported without a subsidy. Neither finished products nor components of the finished product benefit from an export subsidy. However, beginning in February 1997, new rules implemented by the EU recast traditional inward processing to allow the use of export subsidies for components of processed cheese. According to Eurostat, the EU exported about 3,000 metric tons of processed cheese using this scheme in 1995/96. Processed cheese exports treated in this way jumped to 17,000 tons in 1996/97 and to an estimated 65,000-70,000 tons in 1997/98.

The Commission argues that "inward processing" increases third country exports to the EU. Non-subsidized components from third countries (such as New Zealand powdered milk) may be used to produce the cheese. Nevertheless, non-EU cheese manufacturers fear that the EU will be able to undercut their prices by allocating its export subsidies this way. Additionally, there is the fear that an EU policy of transferring subsidies from one product category to another could spread to other agricultural products, such as using grain export subsidies to produce low cost poultry. This would weaken the WTO's export subsidy commitments, which depend on specific commodity definitions.

Canada establishes a two-tier price system for milk: Prior to August 1, 1995, the Canadian government assessed a levy on dairy producers to fund subsidized exports of surplus dairy products. On that date, the Canadian government initiated a two-tier price system that prices milk cheaper to processors when used in the export of manufactured dairy products than when used domestically. Canada represents only about 1 percent of global trade in dairy products, but its dairy exports have grown significantly in recent years. New Zealand and the United States have complained to the WTO that Canada's milk pricing system allows it to circumvent its export subsidy commitments. Canada has notified to the WTO only those dairy product exports that have been subsidized with funds obtained from producer levies.

Hungary also had problems meeting original obligations: In September 1997 Hungary submitted a request to the WTO's Council for Trade in Goods for a waiver from its export subsidy obligations. Hungary alleged that its base period export subsidies were not calculated correctly, due to trade conducted in non-convertible currencies and other ad-hoc arrangements that were unknown by the administrative body estimating Hungary's base subsidies. Consequently, Hungary argued that its base outlay level was set at $423 million when it should have been set at $1 billion. Hungary claimed that its export subsidy schedule did not permit subsidies to a level that would maintain Hungarian market share of its agricultural exports. Hungary argued that preserving its level of agricultural exports is critical to a country in a transition period and requested that revised commitments be put in place until January 1, 2002, when the country would agree to comply with its original export subsidy limits.

On October 22, 1997, the WTO agreed to grant Hungary the requested waiver and set revised export subsidy commitments, based on Hungary's request. Hungary's government is required to submit annual reports on the waiver's anniversary date that explain how it has applied the waiver. The annual notice is supplementary to Hungary's export subsidy notification.

New Disciplines on Agricultural Export Credit Guarantees Under Negotiation in the OECD

Most major exporting nations guarantee commercial credit for sales of agricultural products, and, in some cases, insure sales on special terms if the sales are viewed to be in the exporting country's "national interest." Exporting nations offer to guarantee private bank loans with competitive (commercial) interest rates, loan terms (more than 6 months to as much as 10 years), and, in some cases, freight coverage. Export credit guarantees expand importers' demand for agricultural products when importers have difficulty obtaining foreign exchange. Credit guarantees can help stabilize economies in crisis by allowing countries to continue importing agricultural products and obtain inputs such as cotton and hides for export industries.

Export credit guarantees are grounds for competition among exporters. As export price subsidies are reduced under the URAA, the competitive aspects of credit guarantees have come under increasing scrutiny. Uruguay Round negotiators agreed to continue talks in the Organization for Economic Cooperation and Development (OECD) to establish disciplines on agricultural export credit guarantees, but major exporters have not yet reached an agreement.

Future Talks May Focus on Further Subsidy Reductions

For the next round of WTO talks on agriculture, the United States and the Cairns Group are calling for the complete elimination of export subsidies and for rules to prevent circumvention of export subsidy commitments. In the Cairns Group's opinion, "it is essential that the 1999 negotiations ensure the early, total elimination and prohibition of all forms" of export subsidies. The Cairns Group also is pushing negotiators in the OECD to apply to agricultural credit guarantees the same international laws that govern government-guaranteed export credits for manufactured goods. The Cairns Group's pleas for subsidy elimination may gain credence if importing countries' difficulties in obtaining credit incite major exporters to step up their competition for those markets with larger export subsidies and generous credit terms.

Another high-profile issue is whether the URAA definition of an export subsidy already covers all export marketing practices that could be considered export subsidies or whether additional refinements in the definition are needed to restrict some of the current subsidy circumventions. Decreasing world grain prices and deteriorating economic conditions in key importing countries will spur further debates on the conditions under which international food aid may be exempted from export subsidy restrictions.

Conclusions

Prior to the URAA, export subsidies were an important policy tool in agricultural trade, particularly for trade in grains and dairy products. In signing the URAA, countries that employed export subsidies agreed to reduce the volume and value of their subsidized exports over the period 1995/96 to 2000/01. To date, most of the 25 countries that agreed to reduce their export subsidies have met their commitments.

In 1995 and 1996, grains accounted for the largest volume of subsidized exports, but because grain prices were high, subsidized exports of grains were far below both volume and value commitment levels, though they increased in 1996. In terms of volume commitments, those that have come closest to being filled are other milk products, cheese, and bovine meats. Again, due to high prices, the grain and oilseed volume and value allotments were barely used in 1995 and only slightly more in 1996.

Very few countries have changed their policies substantially to conform with their export subsidy commitments or to plan for reduced commitments in the future. The EU, by far the largest export subsidizer, continues to rely on export subsidies to bridge the gap between high domestic support prices and lower world prices. The enlargement of the EU's Common Agricultural Policy (CAP) to some of the Central European countries enhances pressures to reduce domestic agricultural prices in the EU and avoid excessive levels of export subsidies.

Some countries did change their policies to "conform" to their URAA export subsidy commitments. The countries appear to have implemented practices that allow them to circumvent those commitments and undermine the substantial export subsidy disciplines of the URAA. In the eyes of their trading partners, the EU and Canada's export marketing policies for dairy products allow them to circumvent their export subsidy commitments.

For the upcoming multilateral negotiations, the United States and the Cairns Group of countries are calling for the complete elimination of agricultural export subsidies and for rules to prevent the circumvention of export subsidy commitments. Their call to eliminate subsidies may gain credence if importing countries' market conditions and financial problems encourage major exporters to compete for those markets with larger export subsidies and generous credit terms. Deteriorating economic conditions in key importing countries also will spur further debates on the conditions under which international food aid may be exempted from export subsidy restrictions.